

INDUSTRY	METALS
CMP (as on 30 Oct 17)	Rs 718
Target Price	Rs 818
Nifty	10,364
Sensex	33,266

KEY STOCK DATA			
Bloomberg	TATA IN		
No. of Shares (mn)	971		
MCap (Rs bn) / (\$ mn)	698/10,759		
6m avg traded value (Rs mn)	3,521		

STOCK PERFORMANCE (%)		
52 Week high / low	Rs 735 / 366	
	3M	6M
Absolute (%)	30.1	59.9
Relative (%)	27.2	48.7

Source : BSE

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Europe's miss mars the show

Tata Steel numbers missed estimates, (Consolidated EBITDA: Rs 47.2bn, 53.7% YoY, -5.1% QoQ, Est Rs 54.6bn), driven by lower spreads in European operations (EBITDA/T: USD45, (33.1)/(44.3)% YoY/QoQ, Est USD81). Domestic numbers remained strong (EBITDA/T: Rs 10,959, 50.2/1.6% YoY/QoQ, Est: 11,547). Kalinganagar ops reached full ramp-up in 2QFY18, with BF/downstream utilisations at 100%/95% respectively.

With domestic spreads at historic highs, profitability should remain elevated for steel companies. For Tata Steel, the progression of the JV with thyssenkrupp in Europe is a key monitorable, as it would pare down debt. With domestic assets (Essar, Bhushan, Electrosteel) up for grabs under the insolvency resolution process, Tata Steel can add meaningfully to its portfolio at reasonable valuations. We remain constructive, with an unchanged TP of Rs 818.

Financial Summary (Consolidated)

(Rs bn)	2QFY18	2QFY17	YoY(%)	1QFY18	QoQ(%)	FY16	FY17	FY18E	FY19E	FY20E
Net Sales	321.0	258.4	24.2	293.9	9.2	1,019.6	1,123.0	1,200.5	1,267.3	1,315.0
EBITDA	47.2	30.7	53.7	49.7	(5.1)	79.7	170.1	192.2	215.9	230.0
PAT	10.3	(0.1)	NM	15.5	(33.4)	(18.3)	39.5	64.0	82.1	88.3
Diluted EPS (Rs)	10.63	(0.11)	NM	15.96	(33.4)	(18.9)	40.6	65.8	84.4	90.8
P/E (x)						(38.1)	17.7	10.9	8.5	7.9
EV / EBITDA (x)						19.1	9.1	7.7	6.7	5.9
RoE (%)						(4.2)	10.3	16.8	18.6	17.1

Source: Company, HDFC sec Inst Research

Other key highlights

- Higher deferred taxes (one-off) on account of BSPS pension settlement drove up the consolidated tax rate (54%), and resulted in lower earnings (Rs10.2bn vs estimated Rs 34.9bn). The BSPS settlement numbers have been passed through other comprehensive income, below the headline earnings. Net debt increased to Rs 783bn (vs Rs 717bn in 1QFY18), primarily on account of translation difference (~Rs16bn), and payment of GBP 550mn for BSPS settlement.
- Near-term outlook:** Both domestic and European numbers should improve hereon, given stable prices and falling coking coal costs. For Europe, 3Q is lean volume-wise, and that may weigh down the numbers in the interim. We have largely retained our earnings estimates. Execution uncertainties in the European JV form a key risk to our thesis on Tata Steel.

Consolidated EBITDA was below estimates (Rs 47.2bn, 53.7% YoY, -5.1% QoQ), largely driven by disappointment in Europe

Higher deferred taxes (one-off) on account of BSPS pension settlement, drove up the consolidated tax rate (54%), and resulted in lower earnings (Rs10.2bn vs estimated Rs 34.9bn). The BSPS settlement numbers have passed through other comprehensive income.

Quarterly Financials Snapshot (Consolidated)

(Rs mn)	2QFY18	2QFY17	YoY (%)	1QFY18	QoQ (%)
Net Sales	321,010	258,420	24.2	293,866	9.2
Other operating Income	3,631	791		1,700	
RM Costs	142,896	93,417	53.0	110,699	29.1
Employee costs	42,941	43,527	(1.3)	43,039	(0.2)
Other operating expenses	91,598	91,556		92,091	
EBITDA	47,207	30,711	53.7	49,739	(5.1)
Other income	2,532	1,089		1,555	
Interest Cost	13,499	13,510		13,437	
Depreciation	14,733	14,669		15,011	
Exceptional items	(447)	(593)		(6,168)	
Associates	198	(91)		59	
PBT	21,258	2,936	623.9	16,736	27.0
Tax	11,380	3,634		7,405	
RPAT	9,878	(697)	NM	9,331	5.9
E/o (adj for tax)	(447)	(593)		(6,168)	
APAT	10,325	(104)		15,499	(33.4)

Source: Company, HDFC sec Inst Research

Quarterly Financials Snapshot (TATA Steel India)

(Rs mn)	2QFY18	2QFY17	YoY (%)	1QFY18	QoQ (%)
Net Sales	139,104	105,227	32.2	128,356	8.4
Other operating Income	3,106	791		1,350	
RM Costs	54,491	30,161	80.7	35,776	52.3
Employee costs	11,151	11,809	(5.6)	11,577	(3.7)
Other operating expenses	42,814	44,900		52,691	
EBITDA	33,753	19,148	76.3	29,663	13.8
Other income	2,495	1,647		1,121	
Interest Cost	7,092	7,367		7,001	
Depreciation	9,124	9,117		9,664	
Exceptional items	(267)	(643)		(6,168)	
PBT	19,765	3,668	438.9	7,951	148.6
Tax	6,824	1,172		2,886	
RPAT	12,941	2,496	418.5	5,064	155.5
E/o (adj for tax)	(267)	(643)		(6,168)	
APAT	13,207	3,139	320.8	11,232	17.6

Source: Company, HDFC sec Inst Research

Domestic EBITDA/t was marginally below estimates (Rs 10,959, 50.2% YoY, 1.6% QoQ, est 11,547), driven by a small miss on realisations (Rs 45,164/t 12.6% YoY, -3.2% QoQ, Est 46,514).

Kalinganagar ops currently at full utilisations

Europe EBITDA disappointed (USD45/t, -33.1% YoY, -43.4% QoQ, Est USD81), driven by a decline in spreads by ~USD35, vs estimated flattish spreads. The spreads decline is driven mainly by realisations.

Per Tonne Analysis

	2QFY18	2QFY17	YoY (%)	1QFY18	QoQ (%)
India					
Volumes (Deliveries, mT)	3.1	2.6	17.4	2.8	12.0
Blended realisations (Rs/T)	45,164	40,102	12.6	46,675	(3.2)
RM costs (Rs/T)	17,692	11,494	53.9	13,009	36.0
Other expenses	17,521	15,683	11.7	23,370	(25.0)
EBITDA/T (Rs/t)	10,959	7,297	50.2	10,786	1.6
Europe					
Volumes (Deliveries, mT)	2.6	2.3	15.0	2.4	8.3
Blended realisations (US\$/T)	898	804	11.7	894	0.4
RM costs (US\$/T)	423	263	60.7	383	10.4
Spreads (US\$/T)	476	541	(12.1)	511	(7.0)
Other expenses(US\$/T)	431	474	(9.2)	432	(0.3)
EBITDA/T (US\$/t)	45	67	(33.1)	80	(43.4)
South East Asia					
Volumes (Deliveries, mT)	0.7	0.7	3.1	0.6	11.7
Blended realisations (US\$/T)	563	445	26.6	507	11.1
EBITDA/T (US\$/t)	31	16	100.9	6	461.0

Source: Company, HDFC sec Inst Research

Domestic EBITDA/t has remained strong, and we expect further improvement given steel spreads are at historic highs

Europe disappointed and will likely remain soft in the near term, owing to lower volumes in 3Q.

Historical Trends

	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
India									
Volumes (Deliveries, mT)	2.3	2.4	2.7	2.1	2.6	3.0	3.2	2.8	3.1
Blended realisations (Rs/T)	40,539	38,261	38,131	42,328	40,102	41,798	47,410	46,675	45,164
RM costs (Rs/T)	12,603	10,642	11,137	6,896	11,494	10,055	14,175	13,009	17,692
Other expenses	20,313	21,553	19,592	25,343	21,612	20,891	20,960	23,370	17,521
EBITDA/T (Rs/t)	7,990	6,375	7,954	10,380	7,297	11,301	13,585	10,786	10,959
Europe									
Volumes (Deliveries, mT)	3.3	3.4	3.6	2.5	2.3	2.4	2.9	2.4	2.6
Blended realisations (US\$/T)	797	717	683	774	790	778	798	894	898
RM costs (US\$/T)	262	222	198	286	258	293	333	383	423
Spreads (US\$/T)	536	496	485	487	532	485	466	511	476
Other expenses(US\$/T)	547	525	500	437	466	447	362	432	431
EBITDA/T (US\$/t)	(11)	(30)	(15)	51	66	38	103	80	45
South East Asia									
Volumes (Deliveries, mT)	0.69	0.7	0.7	0.7	0.65	0.65	0.7	0.6	0.7
Blended realisations (US\$/T)	446	404	402	464	445	449	514	507	563
EBITDA/T (US\$/t)	16	12	14	43	16	29	33	6	31

Source: Company, HDFC sec Inst Research

Sum Of The Parts Valuation

Valuation Summary	EBITDA	Multiple	Value
Tata Steel India	142,041	7.0	994,284
Others	1,151	5.0	5,755
EV			1,000,038
Net Debt (Adjusted for EUR 2.5bn farmed out to JV)			433,315
Market Cap			566,724
50% of JV Valuation (EUR: 2.96bn)			228,162
Target Price			818

Source: Company, HDFC sec Inst Research

Key Assumptions

	FY16	FY17	FY18E	FY19E	FY20E
India					
Saleable steel volumes (mT)	9.5	11.0	11.7	12.4	12.6
Realisations (US\$/T)	581	622	673	694	726
Iron ore costs (US\$/T)	28	29	31	32	34
Coking coal (US\$/t)	129	180	180	190	200
Steel Spreads (US\$/t)	408	458	486	503	527
EBITDA/T (US\$)	90	131	157	172	186
Europe					
Steel deliveries	11.0	9.9	10.0	10.0	10.0
Steel Spreads (US\$/t)	430	446	510	520	525
EBITDA/T (US\$)	(7)	71	70	75	75

Source: Company, HDFC sec Inst Research

Peer Valuation

Company Name	Market Cap (US\$)	EV (US\$)	EV/EBITDA (x)		P/E (x)		ROE (%)	ROCE (%)
			FY18E	FY19E	FY18E	FY19E		
Baoshan Iron & Steel	25,646	40,507	6.7	6.3	11.4	10.2	10.9	6.1
Hebei Iron & Steel Co Ltd	6,680	19,726	10.6	9.7	14.8	13.5	6.2	3.9
Angang Steel Co. Ltd	6,671	10,313	7.5	7.3	10.1	9.9	7.0	6.6
Xinxing Ductile Iron Pipes	3,562	5,848	10.8	10.1	22.1	18.4	5.5	2.5
Arcelor Mittal	29,877	43,986	5.4	5.4	8.3	9.5	10.7	10.8
Posco	25,721	39,768	5.7	5.6	9.9	9.5	4.8	4.3
Nippon Steel	23,066	44,435	8.2	7.7	11.8	10.9	7.7	3.5
JFE Holdings	13,327	25,259	7.3	6.8	9.6	9.6	7.5	3.3
China Steel Corp (Taiwan)	12,851	21,789	10.4	9.9	22.4	20.1	5.9	4.1
Hyundai Steel Co	6,806	15,816	6.1	5.9	8.3	7.7	5.6	3.4
JSW Steel	9,839	16,211	8.2	7.1	15.1	12.3	16.9	11.1
SAIL	5,088	11,052	14.5	10.2	N/M	18.4	-7.1	-3.7
Tata Steel	10,761	22,173	7.7	6.7	10.9	8.5	16.8	13.6

Source: Company, Bloomberg, HDFC sec Inst Research

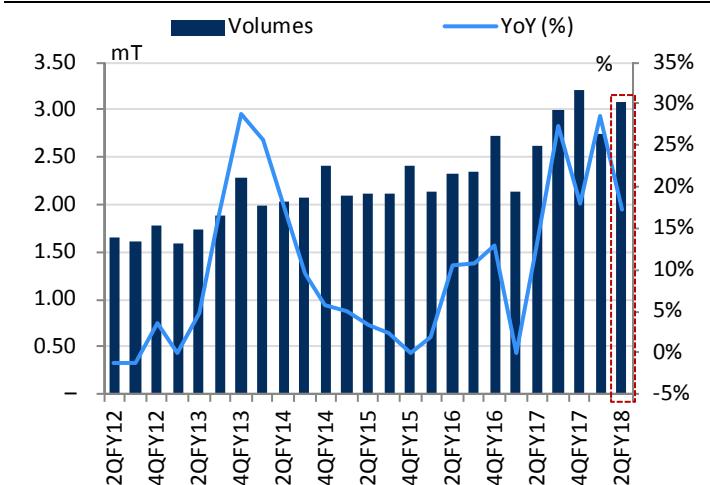
Note: Prices as of Oct 31, 2017 close NM – Not meaningful

ROE (%) and ROCE (%) represent FY18E numbers

EBITDA/t at Rs 10,959.

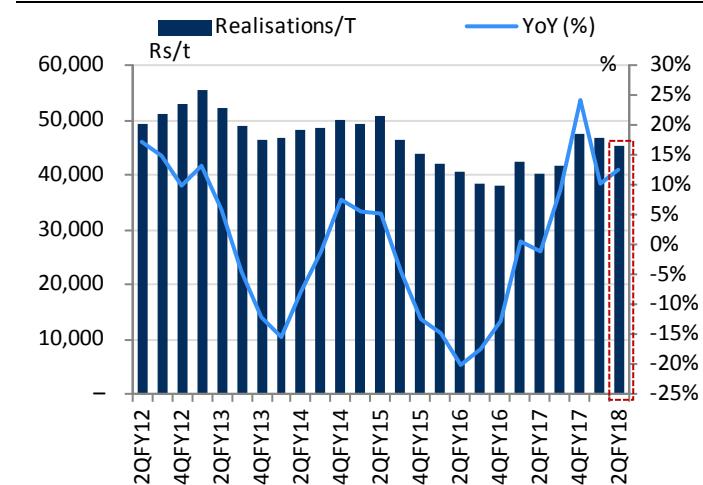
Tata Steel India

K'Nagar Ramp-up Drives Volume Growth



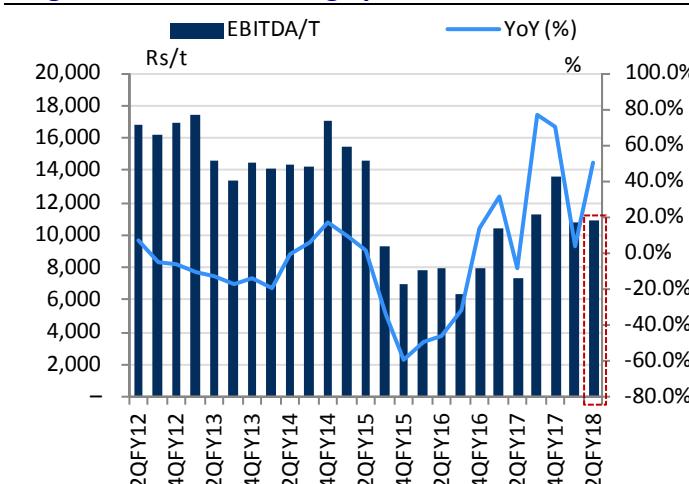
Source: Company, HDFC sec Inst Research

FeCr/Longs prices weighed down realisations



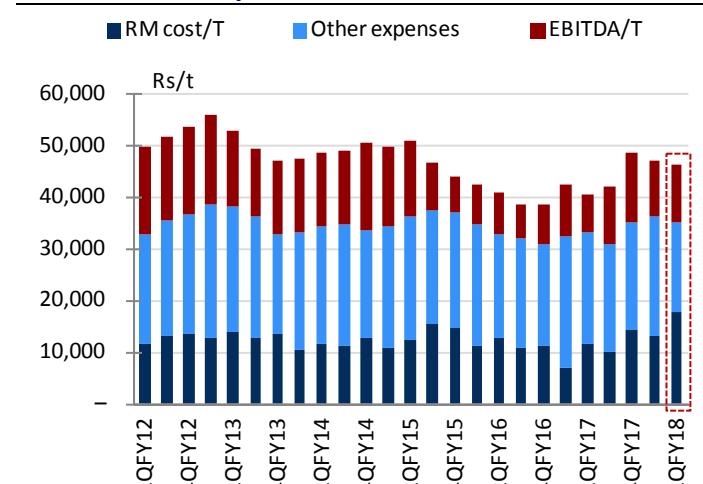
Source: Company, HDFC sec Inst Research

Higher RM Costs Driving Spreads Lower



Source: Company, HDFC sec Inst Research

Lower Other Expenses Led To A Flattish EBITDA/t

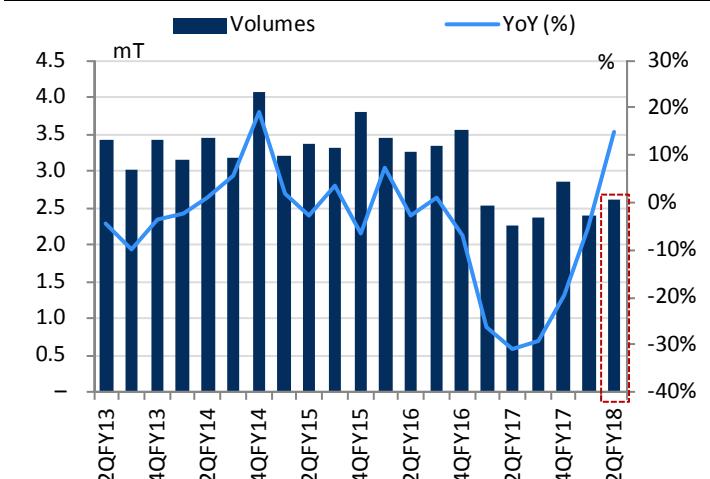


Source: Company, HDFC sec Inst Research

EBITDA/t at USD 45, due to higher RM costs.

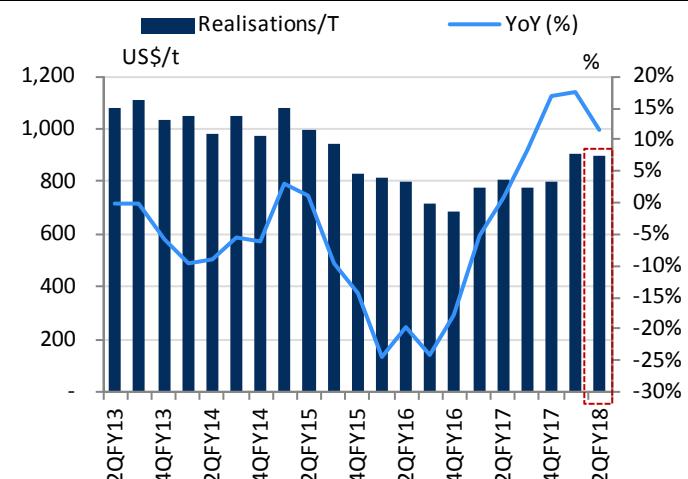
Tata Steel Europe

Volumes Increased 15% YoY



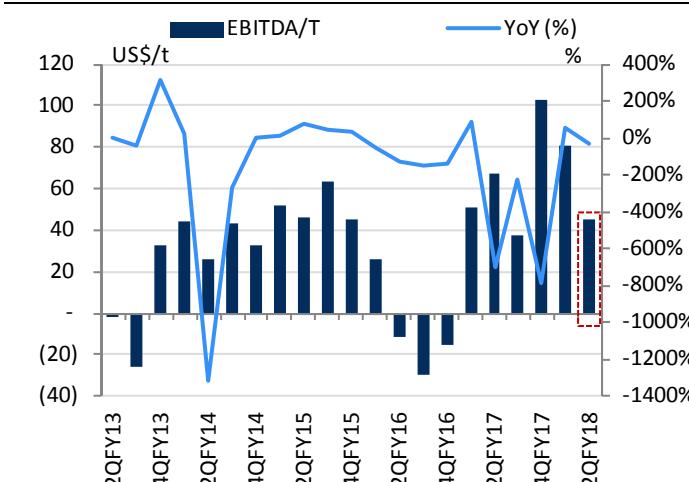
Source: Company, HDFC sec Inst Research

Realisations remained flattish QoQ



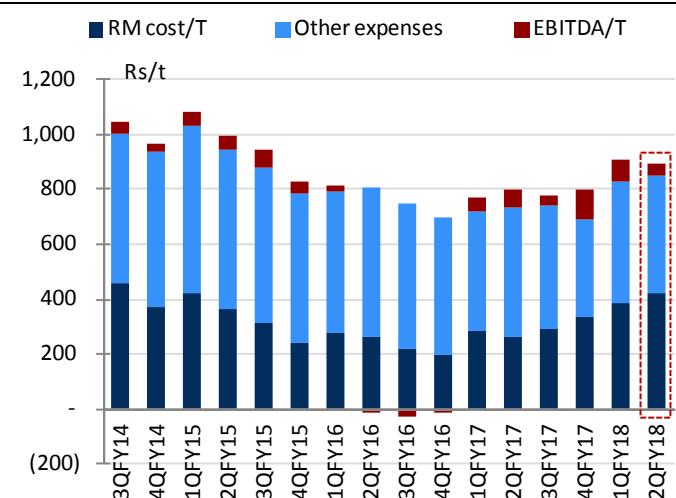
Source: Company, HDFC sec Inst Research

EBITDA/t Declined USD 45



Source: Company, HDFC sec Inst Research

RM Costs Increased Sharply

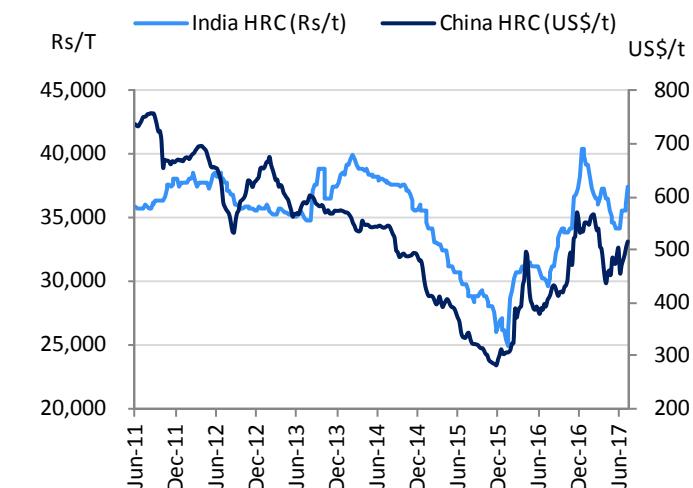


Source: Company, HDFC sec Inst Research

Domestic spreads are beginning to improve.

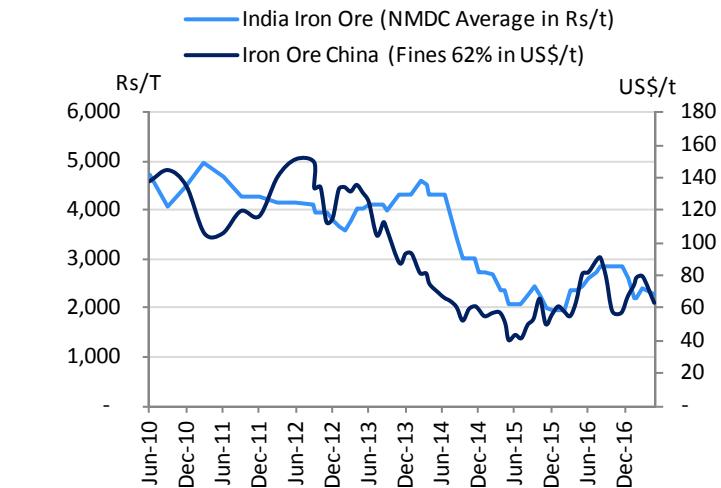
Steel Market Trends

Domestic Pricing Remains Strong



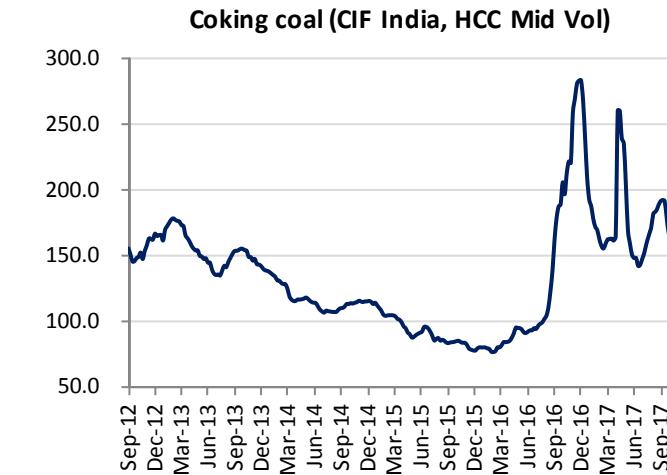
Source: Company, HDFC sec Inst Research

Iron Ore Has Remained Soft



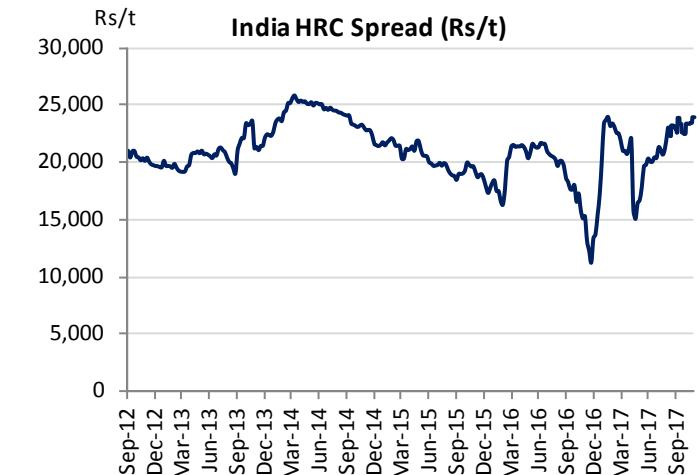
Source: Company, HDFC sec Inst Research

Coking Coal Has Prices Should Trend Down



Source: Company, HDFC sec Inst Research

Higher Prices To Drive Domestic Spreads Higher



Source: Company, HDFC sec Inst Research
Spreads based on NMDC prices and CIF coking coal.

Income Statement

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenues	1,019,647	1,122,994	1,200,537	1,267,337	1,314,957
Growth %	(26.9)	10.1	6.9	5.6	3.8
Material Expenses	406,215	393,049	434,750	453,570	467,122
Employee Expenses	175,876	172,522	157,589	162,562	166,220
Other operating expenses	357,873	387,345	415,995	435,256	451,627
Operating profits	79,683	170,078	192,203	215,949	229,988
Operating Profit Margin (%)	7.8	15.1	16.0	17.0	17.5
EBITDA	79,683	170,078	192,203	215,949	229,988
EBITDA %	7.8	15.1	16.0	17.0	17.5
EBITDA Growth %	(36.4)	113.4	13.0	12.4	6.5
Depreciation	53,064	56,729	57,178	59,217	61,359
EBIT	26,620	113,349	135,025	156,732	168,629
Other Income (Including EO Items)	44,026	(37,968)	(629)	5,815	6,106
Interest	42,214	50,722	46,773	42,244	43,496
PBT	28,432	24,660	87,622	120,303	131,240
Tax (Incl Deferred Tax)	6,900	27,780	29,089	37,474	42,148
PAT	21,532	(3,120)	58,533	82,829	89,092
Minority Interest /Associates	39	(646)	(678)	(712)	(748)
EO Loss / Profit (Net of Tax)	39,904	(43,242)	(6,168)	-	-
APAT	(18,333)	39,476	64,023	82,117	88,344
APAT Growth (%)	NM	NM	62.2	28.3	7.6
EPS	(19)	41	66	84	91
EPS Growth (%)	NM	NM	61.77	28.32	7.59

Source: Company, HDFC sec Inst Research

NM: Not Meaningful

Balance Sheet

As at March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
SOURCES OF FUNDS					
Share Capital	9,702	9,702	9,702	9,702	9,702
Reserves	404,873	345,741	394,188	466,889	545,809
Total Shareholders Funds	414,576	355,443	403,890	476,591	555,512
Minority Interest	7,809	16,017	16,017	16,017	16,017
Long Term Debt	671,478	662,973	662,973	662,973	662,973
Short Term Debt	177,308	197,442	164,161	114,161	114,161
Total Debt	848,785	860,415	827,134	777,134	777,134
Deferred Taxes	87,934	91,442	91,442	91,442	91,442
Long Term Provisions & Others	(7,271)	77,662	77,662	77,662	77,662
TOTAL SOURCES OF FUNDS	1,351,833	1,400,979	1,416,145	1,438,846	1,517,767
APPLICATION OF FUNDS					
Net Block	689,747	891,625	889,447	890,230	893,872
CWIP	359,961	157,841	157,841	157,841	157,841
Goodwill	40,676	34,947	34,947	34,947	34,947
Investments	56,706	64,893	64,893	64,893	64,893
LT Loans and Advances	45,240	45,346	45,346	45,346	45,346
Total Non-Current Assets	1,192,329	1,194,654	1,192,476	1,193,259	1,196,900
Inventories	200,133	248,038	232,176	274,758	251,224
Debtors	120,662	115,868	124,239	129,228	133,763
Other Current Assets	28,123	36,124	36,124	36,124	36,124
Cash & Equivalents	112,316	109,015	131,756	128,751	215,034
Total Current Assets	461,235	509,045	524,296	568,862	636,145
Creditors	185,567	185,745	183,651	206,299	198,303
Other Current Liabilities & Provs	116,163	116,975	116,975	116,975	116,975
Total Current Liabilities	301,730	302,720	300,626	323,274	315,279
Net Current Assets	159,505	206,326	223,669	245,588	320,867
TOTAL APPLICATION OF FUNDS	1,351,833	1,400,979	1,416,145	1,438,846	1,517,767

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	28,471	24,014	86,783	119,422	130,315
Non-operating & EO items	(4,122)	(5,275)	629	(5,815)	(6,106)
Interest expenses	42,214	50,722	46,773	42,244	43,496
Depreciation	53,064	56,729	57,178	59,217	61,359
Working Capital Change	2,863	(8,222)	5,398	(24,924)	11,004
Tax Paid	(6,900)	(27,780)	(29,089)	(37,474)	(42,148)
OPERATING CASH FLOW (a)	115,589	90,188	167,672	152,670	197,920
Capex	(132,180)	(45,707)	(55,000)	(60,000)	(65,000)
Free cash flow (FCF)	(16,591)	44,481	112,672	92,670	132,920
Investments	68,462	(83,839)	0	0	0
Non-operating Income	4,122	5,275	(629)	5,815	6,106
INVESTING CASH FLOW (b)	(59,596)	(124,272)	(55,629)	(54,185)	(58,894)
Debt Issuance / (Repaid)		(38)	0	0	0
Interest expenses	49,960	11,630	(33,281)	(50,000)	0
FCFE	(42,214)	(50,722)	(46,773)	(42,244)	(43,496)
Share Capital Issuance	(4,723)	10,664	31,988	6,242	95,530
Dividend	(9,263)	(9,247)	(9,247)	(9,247)	(9,247)
FINANCING CASH FLOW (c)	(1,517)	(48,377)	(89,301)	(101,491)	(52,743)
NET CASH FLOW (a+b+c)	54,476	(82,460)	22,741	(3,006)	86,283
EO Items / Others	(40,417)	79,159			
Closing Cash & Equivalents	112,316	109,015	131,756	128,751	215,034

Source: Company, HDFC sec Inst Research

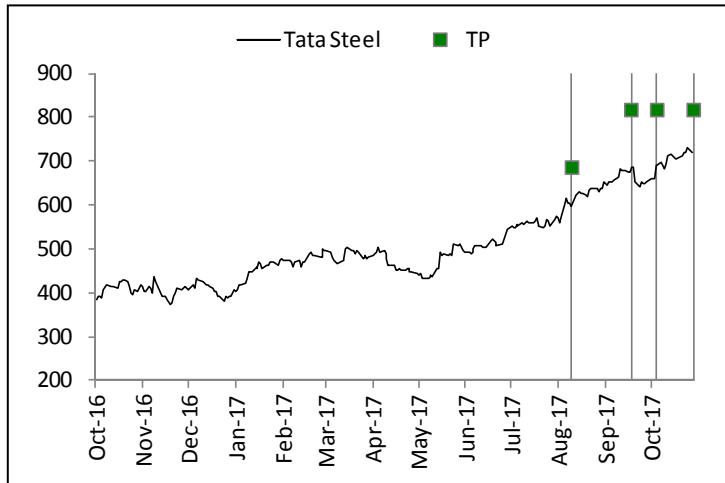
Key Ratios

	FY16	FY17	FY18E	FY19E	FY20E
PROFITABILITY (%)					
EBITDA Margin	7.8	15.1	16.0	17.0	17.5
APAT Margin	(1.8)	3.5	5.3	6.5	6.7
RoE	(4.2)	10.3	16.8	18.6	17.1
Core RoCE	6.3	8.7	13.6	15.1	16.4
RoCE	5.4	7.5	11.6	12.7	12.9
EFFICIENCY					
Tax Rate (%)	NM	25.7	20.0	25.0	25.0
Asset Turnover (x)	0.9	0.9	0.9	0.9	0.9
Inventory (days)	77	70	69	69	69
Debtors (days)	44	37	35	35	35
Payables (days)	63	58	53	53	53
Cash Conversion Cycle (days)	58	49	51	51	51
Debt/EBITDA (x)	10.3	5.0	4.4	3.7	3.4
Net D/E	1.78	2.11	1.72	1.36	1.01
Interest Coverage	0.7	2.3	3.0	3.8	4.0
PER SHARE DATA					
EPS (Rs/sh)	NM	40.6	65.8	84.4	90.8
CEPS (Rs/sh)	35.8	99.1	124.6	145.3	154.0
DPS (Rs/sh)	8.0	8.0	8.0	8.0	8.0
BV (Rs/sh)	426.9	366.0	415.9	490.7	572.0
VALUATION					
P/E	NM	17.7	10.9	8.5	7.9
P/BV	1.7	2.0	1.7	1.5	1.3
EV/EBITDA	19.1	9.1	7.7	6.7	5.9
OCF/EV (%)	8.1	6.2	12.0	11.3	15.7
FCF/EV (%)	(1.2)	3.1	8.1	6.9	10.6
Dividend Yield (%)	1.1	1.1	1.1	1.1	1.1

Source: Company, HDFC sec Inst Research

NM: Not Meaningful

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
11-Aug-17	606	BUY	687
21-Sep-17	688	BUY	818
6-Oct-17	661	BUY	818
31-Oct-17	718	BUY	818

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period

NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period

SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:

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